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Corporate governance systems and codes of good practices in Central Eastern Europe

**(Systemy i kodeksy dobrych praktyk nadzoru
(władania) korporacyjnego w Europie Środkowo-
Wschodniej)**

**Współczesne problemy nadzoru korporacyjnego
Sopot, 29-31 maja 2011 r.**

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The aim of the paper is to present a survey and preliminary assessment of corporate governance systems chosen in the countries belonging to a broadly defined Central Eastern Europe (CEE) - Albania, Bosnia and Herzegovina, Belarus, Bulgaria, Croatia, Czech Republic, Estonia, FYR Macedonia, Hungary, Kosovo, Latvia, Lithuania, Moldova, Montenegro, Poland, Romania, Serbia, Slovakia, Slovenia and Ukraine

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Topics of consideration

Economic, political, legal, cultural and historic determinants

Normative characteristics of corporate governance – introduction of various codes of good practices in the countries of the region

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Topics of consideration

Answering the question whether experience stemming from reforms of centrally planned economies has produced new more universal insights helpful for practice and theory of corporate governance worldwide, both in the established market economies and in emerging markets

Building corporate governance in CEE: Practice without theory

Corporate governance can be described with the following characteristics (1):

- prevailing concept of the firm**
- board system**
- salient stakeholders able to exert influence on managerial decision-making**

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Corporate governance can be described with the following characteristics (2):

- importance of stock markets in the national economy,**
- presence or absence of an external market for corporate control**
- ownership structure**

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Corporate governance can be described with the following characteristics (3):

- extent to which executive compensation is dependent on corporate performance**
- time horizon of economic relationships**

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Four types of systems of corporate governance can be distinguished:

Anglo-Saxon, the Germanic, the Latin and the Japanese

In simplified approach three systems (models) are distinguished – one-tier (Anglo-Saxon, two-tier (German/continental/Japanese) and an option to choose one of the two systems.

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“Learning and doing” approach

Building of corporate governance in Central Eastern Europe had two objectives:

- 1. Helping to implement immediate changes in economy associated with the initiation of reforms at macro and micro levels.**
- 2. Leading towards creating an efficient stable systems of corporate governance.**

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Two stages:

- 1. Embodying the pre-reform period (political revolutions), and first reforms including privatization and establishing the initial forms of corporate governance (1990-1996)**
- 2. Completion of basic reforms, consolidation of market economy by establishing more stable mechanisms of corporate governance - transforming a transition economy into creating an emerging market (1997.....)**

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What kind of corporate governance system had to be developed under the specific country conditions:

Two-tier, “controlled” system like in Germany and Japan

One-tier, “market-based” (the Anglo-American model)

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What kind of corporate governance system had to be developed under the specific country conditions:

An ‘implicit rules-based’ (like in Italy)

A ‘mixture of a capital market-based system and a bank-based system’ (Dutch case)

To elaborate a unique “country-oriented” system

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“Primitive accumulation” could be relevant both for studying the reforms and development of corporate governance in Central Eastern Europe.

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Illicit behavior associated with corporate governance was described by specific terms (1):

- assets stripping, looting
- tunnelling (for the Czech case)
- *prikhvatizazija* (for privatization in Russia)

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Illicit behavior associated with corporate governance was described by specific terms:

- ***spontaneous* privatization (in Hungary)**
- ***collusion* privatization or *mass fraud* (for mass privatization)**
- ***hijackers-swindlers* privatization (for MEBO (Management-Employee Buy-Outs) schemes in Bulgaria)**

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**Overview of state-of-the-art of knowledge in that
field in the period immediately before and after
beginning of reforms (1989-1996)**

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Classical problems resulting from separation of ownership and control described by Berle and Means [1932] were already well-known in the world economic theory and practice

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Agency theory – [Fama, 1980 Jensen and Meckling, 1976 Fama and Jensen, 1983, 1983a Grossman and Hart, 1983]

The role of contractual theory of the firm in corporate governance [Hart and Moore, 1988 Hart, 1995] was also known in the first stage of transition, although no deepened applications of that approach were made to study development of corporate governance in CEE

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Privatization and mass privatization

The discussion on those topics was conducted in the first half of the 1990s, running parallelly to the process itself - [Frydman and Rapaczynski 1992, 1993, 1994 Frydman, Rapaczynski, and Earle 1993, 1993a], [Frydman, Phelps, Rapaczynski, and Shleifer, 1993]

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Privatization and mass privatization

Attempts to apply advanced theoretical concepts to study privatization and building corporate governance in Central Eastern Europe were not too numerous in the beginning of reforms [Frydman and Rapaczyński, 1993]

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Theories of governance based upon transaction costs theory [Williamson, 1988, 1996]

Stakeholder theory [Freeman, 1984], [Donaldson, and Preston, 1993]

Stewardship theory - second period of reforms, (after 1996) [Davis, Schoorman, Donaldson, 1997]

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- **economic determinants**
- **political determinants**
- **historic and cultural determinants**
- **legal determinants**

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Economic determinants:

- 1) analyses of efficiency of systems existing in developed countries – Anglo-Saxon model vs. continental model**
- 2) dominant economic theories – liberalism and the impact of Anglo-Saxon, predominantly US concept of market economy**

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Economic determinants:

- 3) ownership and control – patterns of their separation and their interdependence**
- 4) higher efficiency of private-owned/private controlled companies vs. lower efficiency of state-owned/state controlled companies**

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Political determinants - first stage (1990 – 1996):

- 1) limited local, usually historical, ideas and traditions of corporate governance**
- 2) expectations for assistance in gaining experience from abroad and tendency for uncritical acceptance of proposed solutions**
- 3) limited number and experience of actors involved in the process**

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Building corporate governance in CEE:

Practice without theory

Political determinants - first stage (1990 – 1996):

- 4) high level of proneness for illicit behavior**
- 5) belief in absolute integrity and sincerity of foreign investors and advisors among local politicians and advisors**
- 6) specific political and cultural impact, e.g. the USA in Poland and in the Baltic states, Austria and Germany in the Czech Republic, in Hungary and in some post-Yugoslavian states, the Nordic states in the Baltic states**

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Political determinants – second stage (1997.....):

- **introduction of universal norms of good governance - OECD, World Bank, EBRD**
- **implementation of norms and rules from other countries – developed market economies and other emerging markets**
- **making the systems more effective and less prone to abuses and illicit behavior**

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Political determinants – second stage (1997.....):

- **extending the norms to other types of companies, e.g. state-owned (partially and fully)**
- **inclusion into the systems of corporate governance the US experience after the affairs of Enron etc. and the recommendations resulting from the Sarbanes-Oxley Act of 2001**

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Historic and cultural determinants – first and second stage (1990.....) („memory of market”):

- **industrial tradition**
- **impact of foreign patterns**
- **tendency for illicit behavior**

Table 1. Corruption Perceptions Index for Central Eastern Europe in 2010

COUNTRY	Value of the Index
Albania	87
Belarus	127
Bosnia and Herzegovina	91
Bulgaria	73
Croatia	62
Czech Republic	53
Estonia	26
FYR Macedonia	62
Hungary	50
Kosovo	110
Latvia	59
Lithuania	46
Moldova	105
Montenegro	69
Poland	41
Romania	69
Serbia	78
Slovakia	59
Slovenia	27
Ukraine	134

Source: Transparency International [2010]

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**Legal determinants – first and second stage
(1990.....):**

- **continental legal tradition**
- **existing pre-war legal systems**

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**Legal determinants – first and second stage
(1990.....):**

- **irrelevance of pre-war legal systems (different markets)**
- **absence of civil codes and business law – most of former USSR (Belarus, Moldova, Ukraine) and Albania**

Types of systems: two-tier, one-tier, optional choice

Regularities

First, it can be observed that the countries of the region, despite a strong influence of the continental, two-tier system does not have any special preferences

The choice of the system was not based upon thorough analyses of effectiveness of the systems but it rather resulted from individual experience of reformers and their advisors.

Types of systems: two-tier, one-tier, optional choice

Regularities

Second, optional choice – instability, „trial and error”

A significant incentive for introducing optional choice of corporate governance system was the European Public Company (Societas Europaea (SE)), which was proposed in the EU regulations in 2001

Types of systems: two-tier, one-tier, optional choice

Regularities

The link between positive results of reforms, effectiveness of corporate governance and the choice of two-tier system.

The countries who use only that system – Czech Republic, Estonia, Latvia, Poland, Slovakia have stable and relatively advanced and effective systems of corporate governance.

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Types of systems: two-tier, one-tier, optional choice

Regularities

Since it is but a qualitative observation, an opposite argument can also be found. Hungary, Lithuania and Slovenia have relatively well-developed systems of corporate governance based upon the optional choice

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Conclusions

No longer a transition corporate governance but rather corporate governance in the emerging markets, with all strengths and weaknesses common for all those markets worldwide

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Conclusions

Strongly imitational character and absence of significant efforts to develop indigenous systems of corporate governance

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Conclusions

**Development of practice without any theoretical
indigeneous support and with delayed implementation
of existing theories**

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Conclusions

Limited applicability of experiences from Central Eastern Europe for universal theoretical considerations

High applicability of experience for other emerging markets

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Conclusions

Types of corporate governance systems developed and implemented in the countries of Central Eastern Europe

Two tendencies can be observed:

Conclusions

First, a kind of equilibrium between the two-tier systems and optional choice. It shows that the countries of the region tried to follow the others but were not compelled to follow a single pattern

Promotion of optional choice by the European Union will likely stimulate similar approach in the countries which still apply compulsory two-tier system

Conclusions

The choice of two-tier system was caused by historic and legal tradition, and subsequently, implicit expectations towards high effectiveness

Application of optional choice was not based upon long-term experience and research

It was rather an arbitrary decision resulting from the interplay of various political and economic external and internal factors, with no reference to local culture and tradition

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Dziękuję za uwagę!